WORKERS' COMPENSATION ADVISORY COUNCIL

MINUTES ~~ SEPTEMBER 25, 1998 MEETING [10:00 A.M.]
710 JAMES ROBERTSON PARKWAY
HEARING ROOM, FIRST FLOOR
ANDREW JOHNSON TOWER
NASHVILLE, TENNESSEE

The meeting was called to order by Mr. Steve Adams, Chair.

Voting members in attendance:
- Mr. Carter H. Witt
- Mr. Bob Pitts
- Ms. Jimmie K. Corder
- Mr. James G. Neeley
- Mr. Othal Smith, Jr.
- Mr. Jack Gatlin

Nonvoting members in attendance:
- Mr. Jerry Mayo
- Ms. Jacqueline B. Dixon
- Ms. Abbie Hudgens

Ex officio members in attendance:
- Ms. Sue Ann Head, Assistant Commissioner of Labor
  [designee for Commissioner Al Bodie]
- Mr. Neil Nevins, Assistant Commissioner of Commerce & Insurance
  [designee for Commissioner Doug Sizemore]
- Senator Bud Gilbert

Also present:
- M. Linda Hughes, Executive Director
- David Wilstermann, Statistical Analyst

The minutes of the August 27, 1998 Workers' Compensation Advisory Council meeting were unanimously approved.

NEW BUSINESS

1. Report of Willis Corroon [Advanced Risk Management Services]
   Re: Review of NCCI Voluntary Advisory Loss Cost Filing

Mr. Greg Alff, Senior Actuary, Willis Corroon Corporation, was introduced. Mr. Alff then proceeded to present the Willis Corroon actuarial report concerning the proposed NCCI loss cost filing which is to be effective March 1, 1999. His presentation did not review the details of the filing, but rather concentrated on those areas of the filing where Willis Corroon found reason to question calculations, assumptions, or decisions that affect the overall indications proposed by the NCCI.

Mr. Alff first stated the overall indication for a loss cost decrease of approximately 10% is well supported by the NCCI filing. He then proceeded to discuss information which he felt might influence the Advisory Council's recommendation either up or down in a range of -8.3% to -11.6%. Mr. Alff found nothing, based on the information he reviewed, to justify any number outside this range.

The indicated change recommended by the NCCI is calculated based on current loss cost, how much money will be available to pay the losses, and loss adjustment expenses for the policies effective between March 1, 1999 and February 29, 2000. The difference between the money available and the amount those losses and loss adjustment expenses will cost will determine the change necessary in the loss cost. The goal is to have the funds available which are equal to the projected loss cost. The projected cost divided by the funds available equals the indicated change.

The available funds and the projected experience are both derived from the 1995 and 1996 policy years' experience. The NCCI data represents 93-94% of the workers' compensation data for the State of Tennessee. The data for USF&G and data from a small number of minor companies were not included in the analysis for the proposed loss cost filing.

A discussion of the absence of data from USF&G then ensued. Mr. Jerry Mayo noted this is the second year for which USF&G data has not been included and pointed out the Willis Corroon written report indicated if USF&G data had been included the proposed reduction would have been less. Mr. Mayo asked the Department of Commerce & Insurance why the NCCI has not been able to obtain the data from USF&G. Mr. Nevins stated the Department is unsure of the nature of the problem in obtaining the USF&G data and was surprised to find their data was not included in this year's filing. Mr. Nevins stated it is the intent of the Department of Commerce & Insurance to determine what needs to be done to secure that data.

Mr. Robert Blanco of the NCCI indicated USF&G is having a national computer problem which is not limited to only Tennessee. A USF&G computer contractor is unable to report the data in a format which can be utilized by the NCCI. Therefore, in making the proposed filing, the NCCI did not consider any data from USF&G. Mr. Witt then remarked that while his past votes on this issue indicate his support for continued decreases, he cautioned that without the USF&G data the losses could in reality be much more than indicated by a filing which omits USF&G's experience.

The NCCI representatives indicated it does not know when USF&G data might be available. Mr. Mayo noted that caution might be in order as the filing which the Advisory Council is evaluating is a "best case scenario" without USF&G data. Terri Robinson, NCCI representative, stated the NCCI reviewed the USF&G financial data to analyze how much USF&G's experience could impact the market. According to the NCCI's evaluation, unless the losses of USF&G are outrageous, their experience will impact the NCCI's recommendation to some extent, but it would not give rise to a 5% swing. Mr. Mayo noted, and NCCI agreed, that in the current competitive market even a 2% swing is significant. According to the NCCI filing USF&G has 6.6% of the workers' compensation market and 10-12% of the losses in Tennessee.

Senator Gilbert then inquired as to the long term plan concerning USF&G and whether the State, as a policy, intends to allow insurance companies to write insurance in Tennessee if they are not going to report data which will allow Tennessee to make accurate and sound decisions on what the loss cost filing should be. He asked the Department of Commerce & Insurance whether there is a policy tool available. Mr. Nevins said this situation does cause the Department a great deal of concern and there needs to be some type of resolution reached to avoid continued years of no data from USF&G policies. Ms. Robinson stated the NCCI would be happy to provide more detailed information concerning the USF&G problem to the Department of Commerce & Insurance. Sen. Gilbert reminded everyone that in 1996 the legislature gave the Department of Commerce & Insurance plenary power to get any information needed from any insurance companies, rule making authority to require the data be made available and the enforcement mechanisms to assure the rules are followed.

Mr. Adams asked whether someone had contacted USF&G last year to determine whether the company is Y2K compliant and whether Tennessee will be able to obtain the data after that date. Mr. Nevins said the NAIC [National Association of Insurance Commissioners] has surveyed all the insurance companies and the Department of Commerce & Insurance has issued a survey to the Tennessee domestic companies [150] and it appears most companies are in good shape. Mr. Adams noted USF&G may not be planning to make changes in its computer system until Y2K; however, they do represent 7% of the business which is a sizeable portion to discard for one company and some effort should be made to get them to report the data.

Mr. Witt stated the Advisory Council should keep in mind that the absence of USF&G data could cause a potential 2-3% difference in the ultimate loss cost calculation and that while he favors decreases which can be supported, he cautioned this issue should not be ignored in the Advisory Council's deliberations. Mr. Adams, after acknowledging he was not an actuary, stated it would appear, if USF&G represents only approximately 7% of the business, its experience would have to deviate greatly from everybody else's experience to represent a 200 basis points' difference, which did not seem mathematically possible. Mr. Adams reminded the Advisory Council that while the

Department of Commerce & Insurance has the time and ample opportunity to try to quantify the possible impact of the USF&G data and to consider this in making its final decision concerning the loss cost approval, the Advisory Council has a time deadline as to its recommendation.

Senator Gilbert then moved that the Advisory Council express its concern to the Department of Commerce & Insurance about the two year lack of data from USF&G and that the Department of Commerce & Insurance be requested to investigate this matter and employ all appropriate measures in contacting USF&G to encourage them to submit the data as soon as possible in the future; to express the effect the absence of the data has on the Advisory Council's deliberations; and to report back to the Advisory Council at its next meeting as to what steps can be taken to alleviate this burden in the future. The motion was seconded and passed unanimously.

Following that discussion, Mr. Alff continued his formal presentation. He stated to the extent USF&G losses do exceed the premiums - which is implied although not certain- the indication for a decrease in loss cost may be biased in the negative sense which should be kept in mind as the loss cost filing is analyzed. Mr. Alff agreed with Mr. Adams that USF&G losses would have to be extremely out of line to have a major impact, but he brought up the absence of the data because it does introduce a bias which needs to be considered.

Mr. Alff explained projected loss experience is obtained by: taking the losses reported at 12-31-97 and developing them to ultimate; loading for the current loss cost provision, trending to the proposed policy year cost level and then increasing them by the proposed change in loss adjustment expense provision. The result of this calculation is the projected losses and loss adjustment expenses for policies effective March 1, 1999. The calculation elements used by NCCI in making the loss cost filing which are subject to judgment are: (1) loss development, (2) trend, (3) adjustment for change in benefits, (4) weighting of the experience years and (5) the loss adjustment expense provision. Willis Corroon's review of these five elements indicates a difference of opinion with the judgments made by the NCCI in only two areas: (1) loss development and (2) loss adjustment expense provision.

Mr. Alff then discussed generally the issue of loss development. The loss development procedure converts the known losses to ultimate cost level -- the ultimate estimated losses for the claims. The NCCI filing uses the selected loss development pattern of averaging the last two policy years at each age, includes projections of costs from 17th year to ultimate cost and adds a percentage to the loss development for an anticipated trend factor based on historical data from the 1970's. Mr. Alff indicated the NCCI loss development was being influenced by the trends of the 1970's and he does not feel the 1970's upward trend in claims cost is happening in today's environment.

He also looked at the development of Tennessee cases and there is not much development between the 13th and 16th years of claim age. Therefore, there would probably be no development from 17th year to ultimate. In his judgment this trend factor selected by the NCCI is inappropriate and should be removed from the loss development, which accounts for approximately one percent [from 3.6% in the NCCI filing to 2.7%].

Various members of the Advisory Council then raised questions concerning how the trend is developed since current Tennessee workers' compensation law is quite different from the law in effect in the 1970's and now allows lifetime benefits for certain claims. Mr. Smith summarized stating the NCCI is looking at recent data [from policy years 1995 and 1996] but then looks at old claims to see if a trend in the past justifies an additional adjustment to the current data to predict the needs in the future. Ms. Robinson stated the NCCI is trying to predict the needs for 2019 by utilizing current data and current law.

Mr. Alff also questioned the NCCI's judgment regarding the medical development factors because the indicated trend in last year's filing was greater than this year's filing data concerning the actual medical development for the same time period. Therefore, he does not feel the medical development should be as large as NCCI has indicated for policy year beginning March 1, 1999.

Mr. Alff then brought to the attention of the Advisory Council the issue of reserve levels in general and what the insurance industry is doing in the area of case reserves. The insurance industry reserve data cannot be company specific or Tennessee specific. The information he shared was from the recently released *Best's Aggregates and Averages* concerning reserve trends. This information points to the strong possibility that larger loss development factors might be required for current years than were required in the early 1990's.

Mr. Alff indicated two things regarding reserves is important --the initial reserve amounts and how those reserve amounts changed over time. A review of the reserve information showed that while the initial reserves in the early 90's were high, each year after that the industry has set up less as their initial estimate of ultimate loss. In his opinion, this indicates currently the initial reserves being established are less adequate, which does not mean wrong or inadequate, just less adequate. For example, while the 1991 reserve total was 27 billion dollars, in 1997 the industry set up only 17 billion dollars for reserves. Mr. Alff stated the initial number set up as the reserves necessary for the estimate of ultimate cost of the claims was higher than it needed to be, therefore, the insurance companies adjusted the figures to reflect current estimate of ultimate. Also, in each succeeding year, the insurance companies have set up less as the initial estimate of ultimate cost of that specific year's claims. This fact indicates that initial reserves currently being established are less adequate.

Mr. Witt noted that during these same years, in which the reserves were being reduced, the insurance companies were filing for higher premiums. Mr. Alff contented the pricing competition in workers' compensation has been driven by the fact that rates were adequate to pay the claims. Mr. Alff stated he believed this number will develop upward as it did in 1988. In the last couple of years 2.4 billion dollars was released from workers' compensation reserves into the companies' financial statements. Mr. Smith said historically premiums usually lag behind the actual trends [whether up or down] because you only know the data today and are always reacting to past data.

Mr. Alff noted in the early 1980's the reserves initially set by companies developed upward, i.e., money had to be added to the initial reserves to fund the losses. In the early 1990's the companies' initial reserves were over funded because of a perceived bad workers' compensation market which turned out to be better than expected. In his opinion, to the extent there were any excess of funds set up in those financial reserves they are no longer there as they have been released into the companies' profits and current reserves being set are not as large. Therefore, companies have taken all their credit for the periods of over reserving.

Mr. Alff indicated this data is support for his opinion that the loss development factors in the NCCI filing for the 1st to 2nd year and the 2nd to 3rd year of development are likely to be a little larger, but he cannot tell how much different. In his opinion, the NCCI's judgment regarding the development trend are probably a couple of percent low from what is going to be needed when the 1998-1999 losses develop. He recommended the development factors for 1995 and 1996 be revised upward such as to result in approximately 2.0% less decrease than the NCCI indicated loss cost change.

The last development factor which Mr. Alff discussed was loss adjustment expenses or LAE. The NCCI filed for a 1.6% increase in the loss adjustment expense to 19.1. Mr. Alff is of the opinion this increase is not warranted. Mr. Alff reported the unallocated LAE has leveled off and therefore, he is more concerned with the allocated LAE and concentrated the discussion in that area.

The NCCI filing includes an increase of 10.1% for a Tennessee allocated loss adjustment expense [ALAE] --based on averaging the developed 1996 and 1995 ALAE ratios. These numbers are lower in this year's filing than the same numbers in last year's NCCI filing. In last year's NCCI filing the 1996 ALAE was 10.8%; this year the 1996 accident year developed ALAE is 9.0%. Also, the developed ALAE for 1995 accident year in last year's filing was 9.3% and in this year's filing, the actual development resulted in 8.4%. Therefore, in Mr. Alff's opinion, the NCCI projected development of 10.5% for 1997 is too high because for two years in a row this same pattern developed downward. Mr. Mayo noted the development for 1996 workers' compensation law changes is just beginning to show up in 1997. Mr. Alff would select a 9.1% countrywide ALAE, instead of the 9.7% selected by the NCCI.

Mr. Alff also questioned the judgment of the NCCI in increasing the Tennessee relativity from 1.0 to 1.045 for this filing [applied to the selected countrywide LAE of 9.7%] as this would be a large step to say a factor which was less than one in the past would move to 1.045. This relativity factor was based on insurance company annual statement data from only 1997 when in the past the NCCI used three years of annual statement data. Ms. Robinson pointed out that choosing a Tennessee ALAE relativity of 1.045 would not be a further increase, but rather keeps the factor at the 1997 level. Mr. Alff suggests a better figure would be to use a relativity of 1.0 for this year until it can be determined whether the 1997 apparent jump in relativity is only a one year situation.

Therefore, utilizing Willis Corroon's suggestions of a revised selected countrywide ALAE factor of 9.2% multiplied by a revised Tennessee ALAE relativity of 1.0 yields a revised selected Tennessee ALAE factor of 9.1%. Then, combining that with the 9.0% for unallocated loss adjustment factor results in a recommended loss adjustment expense factor of 18.1% rather than the 19.1% proposed by the NCCI. Mr. Alff closed his presentation by pointing out a chart of possible loss cost ranges depending on the selected factors and stated his opinion that the most appropriate choice for the loss cost would be from -9.0% to -10.3%.

Mr. Adams, after noting the Advisory Council is charged with the responsibility of commenting to the Commissioner of Commerce & Insurance regarding the loss cost filing rate, asked for comments from the Advisory Council.

Mr. Smith noted in the past Tennessee has been in the situation where premiums had to be adjusted dramatically, usually upward as a result of a workers' compensation crisis. He noted his concern that if rates are cut too deeply this will result in a rebound effect and next year or the next, major increases will be required to adjust the premiums. In his opinion the Advisory Council should be cautious this time.

Mr. Neeley stated there two areas of concern to him. First, the NCCI requested increase in loss adjustment expense is a significant jump from the prior year and this factor has been on an upward trend in the filings the Advisory Council has been involved with. He also expressed concern that everything appears to be progressing well except the ability to control administrative costs noting this figure is very revealing when it comes to processing the claims in this state and the cost it takes to process these claims. Second, he pointed out the trends the Advisory Council has seen in prior years have all indicated costs are going down and there were no indicators at the time prior decisions were made to indicate there would be any changes other than a continued downward trend. However, for the first time, an upward change might be indicated.

Ms. Hudgens indicated she too found the information regarding trend to be concerning and urged the voting members to take that into account and pay proper consideration to Mr. Alff's concern that the development factors may indicate a 2% less decrease in the indicated loss cost change.

Mr. Nevins told the Advisory Council that the actuary retained by Department of Commerce & Insurance had presented a draft loss cost report to the Department the previous day and that the actuary was present at the meeting and available to discuss any of the preliminary findings if the Advisory Council desired. Mr. Witt indicated he perceived the job of the Department's actuary was to advise the Department, not the Advisory Council. Mr. Adams, after noting there is a reason for a separate process involving the Advisory Council, without objection, declined to hear from the Department's actuary. Mr. Adams then asked whether any member wished to make a motion.

Mr. Pitts stated he was prepared to make a motion but wanted to explain the rationale behind the motion prior to making the specific motion. Mr. Pitts then indicated his motion would incorporate accepting the recommendation of the Advisory Council's actuary on the readjustment of the loss adjustment expense provision by reducing it in half because for several years there had been an effort to move loss adjustment expense up and the next year the LAE keeps coming in below expected levels and until something more concrete appears in the trend, half of that requested by the NCCI would appear to be enough for 1999.

Mr. Pitts noted while some multi-line companies do not necessarily worry the loss cost filing under the belief that they can get to wherever rate they need with the multiplier, this is not as true for single line companies and other potential carriers for the Tennessee market. It was his feeling the Advisory Council has a responsibility to put forward as accurate and appropriate data as possible for the loss cost filing. Additionally, he stated it is very important that the Advisory Council be concerned about where multipliers get because, even though the Advisory Council does not have any responsibility for the assigned risk pool, there are indications multipliers are beginning to creep up and he expressed his concern that a situation not be created in which the multipliers at the upper end of the voluntary market are higher than what is available in the assigned risk pool.

Mr. Pitts continued by noting while the data regarding the trend is not fully quantifiable, it is fair to say that in virtually all of the areas, it appears the trend is up, whether because of the USF&G data being omitted or because of the preliminary indications regarding reserve amounts. For the stated reasons, he moved that the Advisory Council recommend a loss cost of -9.0% in pure premium level, with that figure including the loss adjustment expense being restricted to only half of the amount NCCI had indicated in the filing. The motion was seconded by Mr. Smith.

Mr. Adams then called for discussion on the motion. Mr. Mayo requested the Advisory Council to keep in mind that as claims costs go down and the expenses stay flat, loss adjustment expense percentage will go up; that when insurance companies do a good job in claim management they also get tagged because the loss adjustment expense ratio goes up. Additionally, he noted the Advisory Council is not a policing organization and responsible markets will respond responsibly regarding the rates.

Mr. Adams noted he felt it is important that the Advisory Council should try to prevent insurance rates from yo-yo-ing, as that type of up and down effect creates problems in the market and it is important that efforts are made to keep the rates level and to avoid big price fluctuations.

Mr. Pitts agreed and noted for the insurance industry that he would have no problem with adequate upward adjustment being made in the loss adjustment expense provision if it is based on hard data; however he is concerned that the NCCI projection for LAE is not where it is going to be at the end of the next year and until it gets closer to that figure he did not want to agree to such an increase.

Mr. Adams then called for a vote on Mr. Pitts’ motion and it passed by unanimous vote.

The NCCI was then asked to respond to the inquiry made at the August meeting as to whether the effective date of the current loss cost filing could be changed from March 1, 1999 to January 1, 1999. Ms. Robinson stated such a change, while perhaps possible depending on when Commissioner Sizemore made the decision regarding the loss cost, could not be simply and easily done because of several reasons. First, this would create time line difficulties, especially in the assigned risk market because NCCI cannot make the rate filing until the loss cost has been determined by the Commissioner Sizemore. Second, the NCCI had already sent out modification rates for policy renewals in January and did not designate them as preliminary, which it would have done had it anticipated a new rate would be effective on that date. If it is determined the effective date should be January 1, the NCCI would have to compute new modification factors for those policies renewing on January 1 which it would not be able to do by January 1. Therefore, the rates would have to be retroactive to January 1 and under Tennessee law if the modification factor is higher, the rate cannot be retroactive. Third, the NCCI is implementing a new program in the experience rating area consisting of a different formula which does take effect on March 1. Fourth, some policy holders' premiums will be going up and they will not be happy to see those premiums earlier. She also noted several states are not on a January 1 effective date.

Mr. Nevins noted that was his understanding when this issue was considered in 1997 it was the will of everyone that the effective date continue to be March 1 as opposed to changes back and forth. He indicated if this is not the desire of the Advisory Council or the Oversight Committee the Department could certainly re-evaluate this issue.

In response to a question by Mr. Witt, Ms. Robinson did note the multiplier for the assigned risk plan could be determined prior to January 1, but the rates could not be developed because they do use the loss cost set by the Commissioner.

Mr. Adams then asked for further questions or comments. There being none, he stated the assumption is the new loss cost rate will be effective March 1, 1999.

Mr. Adams also noted this meeting was the final one for Senator Gilbert and expressed the Advisory Council's appreciation and thanks to him.

There was no further business to come before the Advisory Council and the meeting was adjourned at 12:20 p.m., without objection.